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SUBJECT: ECONOMIC FORECAST FOR ITALY 2002-2003: JANUARY
2002 PREDICTIONS

REF: (A) 01 TREAS 172000Z, (B) 01 ROME 52279 (C) 01 ROME

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11. SUMMARY. ITALY'S ALREADY WEAK ECONOMY WILL REGISTER AN ANEMIC GDP GROWTH RATE OF ONE PERCENT IN 2002, WITH A MODERATE ECONOMIC RECOVERY EXPECTED ONLY IN THE SECOND HALF OF THE YEAR. IN 2003, GDP GROWTH IS EXPECTED TO CLIMB ABOVE TWO PERCENT. INVESTMENT WILL PROMPT THE VERY MODEST GROWTH IN 2002, WHILE THE 2003 GROWTH WILL BE SUPPORTED BY EXPORTS AND A GRADUAL ACCELERATION IN GROWTH OF HOUSEHOLD CONSUMPTION, AS WELL AS AN IMPROVED GLOBAL ECONOMIC PICTURE. INFLATION IS EXPECTED TO SLOW OVER THE FORECAST PERIOD, ALTHOUGH THE EURO CHANGEOVER AND AN UNUSUALLY COLD WINTER WILL PUSH INFLATION SLIGHTLY HIGHER IN THE FIRST QUARTER OF THIS YEAR. ONE-TIME MEASURES PROPOSED TO REDUCE THE DEFICIT WILL FALL SHORT OF THE GOI'S OPTIMISTIC PREDICTIONS. CRITICAL STRUCTURAL REFORMS WILL NOT TAKE PLACE IN 2002, MAKING IT DIFFICULT FOR THE GOI TO MEET BUDGET DEFICIT TARGETS FOR 2002. END SUMMARY.

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GDP GROWTH

12. IN THE AFTERMATH OF SEPTEMBER 11 AND THE GLOBAL ECONOMY'S TAILSPIN, ITALY, LIKE THE REST OF THE EU, SAW ITS ECONOMY STUMBLE BADLY. FOURTH QUARTER 2001 RESULTS, ALTHOUGH STILL TRICKLING IN, ARE SHOWING ZERO PERCENT OR EVEN A NEGATIVE GDP GROWTH RATE. THESE RESULTS MORE THAN OFFSET THE STRONG PERFORMANCE OF THE FIRST QUARTER, WHEN GDP ROSE AT AN ANNUALIZED RATE OF MORE THAN 3 PERCENT. WE EXPECT THAT FINAL FIGURES WILL SHOW A GROWTH RATE OF 1.8 PERCENT. AVERAGE EURO-ZONE GROWTH IN 2001 IS EXPECTED TO HAVE BEEN 1.5 PERCENT. FOR ITALY, THIS IS A SILVER LINING IN AN OTHERWISE BLEAK PICTURE.

13. FOR MOST OF THE 1990S AND INCLUDING 2000, ITALY HAS HAD A SLOWER GROWTH RATE THAN THE AVERAGE OF EURO-ZONE ECONOMIES. THE GOI STILL OFFICIALLY FORECASTS THAT GDP GROWTH IN 2001 WILL RANGE FROM 1.9 PERCENT TO TWO PERCENT.

14. THE ACROSS-THE-BOARD WEAK FOURTH QUARTER PERFORMANCE, FROM INDUSTRIAL PRODUCTION TO HOUSEHOLD CONSUMPTION, WILL REVERBERATE FOR MONTHS. GDP GROWTH FOR 2002 IS EXPECTED TO BE AN ANEMIC ONE PERCENT, ACCORDING TO THE CONSENSUS FORECAST OF ITALIAN RESEARCH INSTITUTIONS. THE OECD IN ITS ANNUAL REPORT PREDICTS A GDP GROWTH RATE OF 1.2 PERCENT. IN CONTRAST, THE GOI PREDICTS 2.3 PERCENT GDP GROWTH.

15. WE CONCUR WITH LEADING THINK-TANKS THAT THE GOI'S PREDICTION IS TOO OPTIMISTIC. THE GLOBAL ECONOMY IS NOT EXPECTED TO BEGIN TO REBOUND UNTIL THE SECOND HALF OF THIS

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YEAR, WHICH WILL CONTINUE TO DEPRESS ITALIAN EXPORTS TO ITS MAJOR MARKETS: THE U.S. AND GERMANY. THE LATTER'S MORE PROFOUND ECONOMIC WOES ARE BAD NEWS FOR ITALIAN EXPORTERS, SINCE GERMANY IS THEIR NUMBER ONE EXPORT MARKET.

16. INVESTMENT WILL CONTINUE AT MODERATE RATES. THE GOI PREDICTS THAT THE TREMONTI LAW, WHICH PROVIDES TAX BENEFITS FOR REINVESTED PROFITS, WILL SPUR SIGNIFICANT INVESTMENT IN 2002, WHICH, IN TURN, WILL PROP UP GDP GROWTH. WE BELIEVE THAT, GIVEN GLOBAL ECONOMIC UNCERTAINTIES, ITALIAN COMPANIES WILL MAKE MARKET MOVES CAUTIOUSLY AND POSTPONE MAJOR INVESTMENTS. WE EXPECT THAT THE POSITIVE EFFECTS OF THE TREMONTI LAW WILL ONLY BEGIN TO BE FELT IN THE LATTER HALF OF THE YEAR. THE GOI ALSO EXPECTS AN UPTURN IN

HOUSEHOLD CONFIDENCE AND CONSUMPTION. AGAIN, THE CONSENSUS IS THAT CONSUMERS ARE ADOPTING A WAIT AND SEE ATTITUDE UNTIL THERE ARE SIGNS OF A GLOBAL ECONOMIC RECOVERY. ECONOMIC WOES IN REGIONS OUTSIDE OF EUROPE ALSO MAY HAVE A BOOMERANG EFFECT. SOME 200,000 INVESTORS IN ITALY HAVE ASSETS, THROUGH MUTUAL FUNDS AND INDIVIDUAL STOCKS, IN ARGENTINA. (ACCORDING TO THE LATEST ESTIMATES, ITALIANS OVERALL EXPOSURE IN ARGENTINA IS ABOUT E12 BILLION. TWO

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